Committee on Resources

Subcommittee on Energy & Minerals Resources

Witness Testmony

Statement of
John H. Hill
Senior Analyst, Mining & Metals
Salomon Smith Barney Inc.

Regarding
Mining Regulatory Issues -
The Interior Solicitor's "Millsite" Opinion and
Potential Impacts on Mining Operations and Investment.

To the
Subcommittee on Energy and Mineral Resources
of the
Committee on Resources
U.S. House of Representatives
August 3, 1999

My name is John Hill. I am a senior analyst with Salomon Smith Barney covering the mining and metals industry. In this capacity I perform technical and financial evaluations of publicly-traded mining companies, and provide investment recommendations to the clients of Salomon Smith Barney. By training and experience I am a mineral economist, and have worked internationally as a geologist, operations manager, and financial executive for major mining companies.

The opinions expressed here and during my testimony are mine and do not necessarily reflect the views of Salomon Smith Barney.

Thank you for the opportunity to provide input to the discussion of mining regulatory issues, and specifically on the Interior Solicitor's November, 1997 "Millsite Opinion" and its implications for the mining industry and investors. This discussion within the Interior Department appropriations process is timely, and of pressing importance to companies mining gold, copper, and other metals on public lands in the U.S. As a securities analyst, I view this issue from the perspectives of the investment community, the affected operating companies, and comparative international policy, and offer no legal assessment.

I believe that the "Millsite Opinion" - that the ratio of 5 acre millsite claims to 20 acre mining claims cannot exceed one-to-one - represents a new standard that has not previously been applied to the permitting or patenting of mining projects, and poses a threat to the viability of the U.S. mining industry. While admittedly arcane and poorly understood by investors, it is my opinion that this is unworkable from the engineering perspective and potentially jeopardizes billions of dollars of

investment. I urge the Committee to reject it.

I would like to address some of the popular myths that surround regulatory discussion of hardrock metals mining on public lands.

Myth #1: Mining is unregulated in the U.S. Opponents of mining point to the absence of land reclamation provisions in the Mining Law, implying that the industry is unregulated. In fact, between the Clean Air Act, the Clean Water Act, the Endangered Species Act, the Community Right to Know Act, the EPA, OSHA, MSHA, and State and local reclamation and land use restrictions, the U.S. has the most highly regulated mining industry in the world. We are familiar with projects holding over 40 individual permits covering every aspect of operations, environmental management, monitoring, and reclamation. A "short" EIS and permitting process in the U.S. is two to three years; five to seven years is common.

Myth #2: The Mining Law of 1872 is a "giveaway". Patent fees of $2.50 - 5.00 per acre are portrayed as providing unfettered access and windfall profits to miners, when in fact the patenting process is lengthy; discovering minerals and demonstrating economic viability is expensive, and a moratorium has stalled any new approvals. Further, the public is well-compensated through excise, property, sales, payroll, and income taxes. Ten-year average return on capital for the major US gold companies that we track is quite poor at 5.8%, barely above T-bill yields. Both the gold and copper industries have been reeling from low prices since early 1998, and have seen pervasive losses, write-downs, layoffs and mine closures. Exploration and project development have come to a virtual halt, while equity investors have seen precipitous erosion of share values. There is no windfall.

Similarly, accounts of billions of dollars worth of minerals bought for $2.50 per acre are a fiction, ignoring the capital and operating costs of extraction, the time value of money, and business, technical, and commodity risk discounts. Fair values suggested by the market capitalizations of companies benefiting from this "giveaway" are a fraction of "headline" dollars. Measured by standard financial ratios, relative industry rankings, and cumulative investment performance, mining is in reality a high-risk, capital intensive business with weak long-term profitability.

Calls for the imposition of royalties on mining often overstate profitability and confuse metals economics with the higher-margin oil & gas industry. Revenue-based royalties (usually called Net Smelter Return royalties or NSRs) on metals mining of 1-3% are common features of international fiscal regimes, project finance packages, and private property transactions, and probably have a place in the U.S. Mining Law reform debate. Benefits are simplicity and transparency. NSRs above 4-5% are rare, and are usually only seen in production-sharing schemes as a substitute for complex taxation in unstable countries (e.g. Russia). Sliding scale features tied to metals prices are common, and the following example suggests that a 1-3% sliding scale royalty might be practical. An alternate, although less common, model is the Net Profits Interest Royalty (or NPI), which functions like a simplified income tax.

Myth #3: The "Millsite Opinion" reflects standard practice.

Although comprehensive surveys of the subject are absent, it is my experience that large metals mines tailor their millsite property packages for optimum long-term materials handling and infrastructure utilization rather than according to a set ratio of mine-to-mill claims. The one-to-one ratio - implying a millsite 25% the size of the mine using the standard 5 acre/20 acre claims - is impractical from the

engineering perspective. Large millsites are needed for processing facilities, equipment maintenance, infrastructure, overburden storage, and tailings impoundments. Extracted metals typically constitute a small fraction of the volume of ore mined and processed (one-half ounce of gold per ton of ore is considered rich) - thus the difficulty of storing material mined from 20 acres on a 5 acre millsite. The "Millsite Opinion" embodies a new permitting litmus test, and does not reflect standard industry practice. The millsite ratio does not figure prominently in any of the feasibility studies, investment proposals, or corporate financial reports of the major U.S. mining companies that we research.

Conclusion

The US is perceived as a high-risk country for minerals development due to its lengthy, complex, and frequently hostile environmental permitting procedures. High profile examples of politics prevailing over science, and a fear that "the rules will change" to thwart mine development have helped accelerate the industry's exodus to Central and South America. While the U.S.' mineral endowment is rich and new exploration technology underscores the geologic potential of established mining districts, the reserve base is not being replenished as mature mines shut down, new projects languish at the permitting stage, and exploration dollars flow abroad. Should the "Millsite Opinion" be allowed to stand, we believe investors will interpret it as an effort to ban mining, and will take a pessimistic view of U.S.-based production or development assets in the debt and equity markets. The uncertainty as to company risk exposures, whether "Millsite" provisions will shut down operating mines, allow "grandfathered" non-conforming applications, or apply only to new development projects will further chill investor sentiment.

# # #